

Cite as Det. No. 05-0045, 24 WTD 413 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 05-0045
...)	
)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .

- [1] RULE 159: B&O TAX – AGENT -- TOBACCO PRODUCTS. A person who claims to be acting merely as agent in making purchases of tobacco products will have such claim recognized, for B&O tax purposes, only when the contract or agreement clearly establishes the relationship of principle and agent and the person’s books and records comply with requirements of WAC 458-20-159.
- [2] RCW 82.26.010: TOBACCO PRODUCTS TAX – DISTRIBUTOR. The Tobacco Products Tax is imposed only once, upon the “distributor,” as defined in RCW 82.26.010. A person was liable for tax as the distributor of the tobacco products when the person was engaged in the business of selling tobacco products in this state, was the first person who handled for sale tobacco products that were within this state but upon which tax had not been imposed, and was not acting merely as an agent in purchasing and receiving payment for the tobacco products.
- [3] CHAPTER 82.26 RCW: TOBACCO PRODUCTS TAX – CLAIM OF AGENCY. It would be incompatible with the recordkeeping requirements of Chapter 82.26 RCW to recognize a claim that a person was acting merely as an agent in purchasing and receiving payment for tobacco products, when the person did not maintain any records documenting the name and address of the alleged principal or the dates and quantities of purchases allegedly made for the principal.
- [4] RULE 111: TOBACCO PRODUCTS TAX – CLAIM OF AGENCY. The burden is on the taxpayer to establish the existence of an agency relationship. The Department will not recognize a claim that a person was acting merely as the agent of another in purchasing and receiving payment for tobacco products when the taxpayer provides no evidence that he or she was acting under the control of the purported principal.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Prusia, A.L.J. – A wholesaler of miscellaneous merchandise appeals the assessment of Tobacco Products tax, Business and Occupation (B&O) tax, and litter tax on the wholesale sales price of tobacco products he purchased at an Indian smoke shop in Washington and delivered to another person in this state in return for payment. The taxpayer contends that he purchased the tobacco products solely as agent for the other businessman, and the payments he received were reimbursements of funds he advanced for that person plus \$. . . for each trip to the smoke shop. We conclude that the taxpayer has not shown that he was acting as the agent of another person. He has not established any exception or exemption to B&O tax on the payments received for the tobacco products. We find he was the distributor of the tobacco products and liable for the tobacco products tax. We sustain the assessment of litter tax.¹

ISSUES

- [1] Was the taxpayer acting solely as the agent of another person in making purchases of tobacco products?
- [2] Was the taxpayer the “distributor” of the tobacco products, for purposes of Chapter 82.26 RCW?
- [3] Are there any exceptions or exemptions to taxation, under the facts presented?

FINDINGS OF FACT

In this determination, the term “tobacco products” refers to tobacco products other than cigarettes. We also use the terms “other tobacco products” and “OTP” to refer to such products.

The taxpayer, . . . , is a sole proprietor doing business in [Washington] as a wholesaler of general merchandise. In 2003, federal agencies seized documents from an Indian (Native American) smoke shop in . . . , Washington. Among the documents seized were invoices of sales of tobacco products (OTP) by the smoke shop. Several invoices showed the purchaser as [a name similar to the taxpayer’s] at the taxpayer’s business address. The records relating to that purchaser were forwarded to the Washington State Liquor Control Board (“WSLCB”) for possible investigation. The WSLCB investigated the taxpayer, and found that he had purchased the OTP, and had not paid the Tobacco Products tax that applies to OTP. The WSLCB forwarded the case to the Department of Revenue (DOR) for possible assessment of Tobacco Products tax. DOR’s Tax Recovery Unit conducted a further investigation of the taxpayer’s purchases from the Indian smoke shop.

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

The taxpayer was very cooperative with the WSLCB and DOR in their investigations. He stated he had purchased the OTP, but for another business person, and did not know he would be responsible for the Tobacco Products tax. He identified the other person as a friend named Mr. [A]. The taxpayer stated Mr. [A] had hired him to purchase the OTP at the . . . smoke shop, and deliver them to Mr. [A], for \$. . . per trip. Mr. [A] stated he wanted the taxpayer to purchase the OTP under the taxpayer's state excise tax number, because Mr. [A] had bad relations with the smoke shop. The taxpayer purchased the OTP in the name of his own business, paid for the OTP with his own American Express credit card, delivered the OTP to Mr. [A], and Mr. [A] then reimbursed him for the purchases plus \$ The taxpayer provided the WSLCB with copies of his monthly credit card statements. The taxpayer stated he had nothing in writing about this arrangement with Mr. [A], nor would Mr. [A] provide him with anything after the fact. The taxpayer stated that both he and Mr. [A] were from [a foreign country], and the taxpayer feared that his family in [the foreign country] would be harmed if he tried to press charges or bring legal action against Mr. [A].

The taxpayer provided DOR with additional documentation. He provided a copy of [his business] merchandise list. The list does not include any OTP or cigarettes. He provided copies of American Express statements showing the purchases. Those statements show the taxpayer, the taxpayer's business name] as the cardholder. The taxpayer provided copies of three sales orders as support for his description of events. One sales order is for items sold to the taxpayer's business by "[Mr. A's last name] Sales Co." It itemizes various OTP as well as non-tobacco products, and also lists an unidentified dollar amount. A second is for items sold to the taxpayer's business by [Mr. A's Company name] at the same address as [Mr. A's last name] Sales, and on it OTP and non-tobacco items are itemized, the dollar total of the non-tobacco products is subtracted from the dollar total of the OTP, and the remainder is stated. The taxpayer stated this sales order shows both purchases by the taxpayer from Mr. [A], and reimbursements by Mr. [A] to the taxpayer. The third sales order shows "[Mr. A's last name, Mr. A's Company name]" as the seller, and the taxpayer in the "ship to" field. That order form itemizes and states a total for non-tobacco products, and also lists, separately, with no price stated but with the notation "paid," items of OTP. The taxpayer states the form shows sales by Mr. [A] to the taxpayer of non-tobacco products, together with a reimbursement by Mr. [A] for the listed OTP.

Invoices of OTP sold to the taxpayer by the Indian smoke shop show he purchased OTP on numerous occasions between December 2002 and May 2003, for a total wholesale sales price of \$ The taxpayer does not dispute this figure.

DOR personnel who investigated this matter noted that [the taxpayer] appeared to be credible, but was unable to prove that someone else was responsible for taxes on the OTP.

The Tax Recovery Unit reviewed the documentation related to the taxpayer's purchases of OTP from the [Washington] smoke shop for the period January 1, 2002 through December 31, 2003. On April 7, 2004, DOR's Taxpayer Account Administration Division (TAA) issued an excise tax assessment against the taxpayer for that period, limited to the information examined. The total amount of the assessment was \$. . . [and included wholesaling B&O tax, Tobacco Products tax, Litter tax, penalty, and interest].

The taxpayer appeals the assessment in its entirety.

ANALYSIS

B&O tax

We first address the taxpayer's potential liability for B&O tax.

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220. "Business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. The B&O rate is determined by the type of business activity in which a person is engaged. RCW 82.04.290.

Wholesalers are liable for B&O tax on "the gross proceeds of sales of such business." RCW 82.04.270. "Gross proceeds of sales" means "the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, [etc.]"

The taxpayer states he has never been in the business of selling either OTP or cigarettes, and these transactions involving OTP were not sales and not part of his business activity. With respect to the OTP he purchased from the Indian smoke shop in 2002 and 2003, he states he was only acting as a conduit under the direction of Mr. [A]. He states he was just doing a favor for Mr. [A].

It is undisputed that the taxpayer was engaged in business in Washington, as a wholesaler. Therefore, he is taxable on the gross proceeds of sales of his business. He purchased the OTP in question in the name of his business, paying with a credit card he holds in the name of the business. He delivered the OTP to another person or persons, and received the wholesale price of the OTP from that person or those persons plus a mark up or fee. The manner of his purchases from the Indian smoke shop indicates that the purchases of OTP were purchases by the business. Proceeds from sales of the OTP therefore must be treated as gross proceeds of sales of the business, unless some exception, exemption, or deduction applies.

Exemptions and deductions from tax are narrowly construed. *Budget Rent-A-Car, Inc. v. Department of Rev.*, 81 Wn.2d 171, 500 P.2d 764 (1972). Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 13 P.2d 1084 (1932). A person claiming a tax exemption or exception has the burden of proving he or she qualifies for the exemption or exception. *Group Health Cooperative of Puget Sound, Inc. v. State Tax Commission*, 72 Wn.2d 422, 433 P.2d 201 (1967); Det. No. 89-268, 7 WTD 359 (1989).

[1] One exception to taxing gross receipts is for amounts that merely pass through a business in its capacity as an agent. WAC 458-20-111 (Rule 111) is a general rule which allows taxpayers to exclude advances or reimbursements from gross income as "pass through" payments where the

liability of the taxpayer is solely that of an agent. Rule 111 usually is applied only to purchases of services, because a specific rule, WAC 458-20-159 (Rule 159), addresses when DOR can recognize, in the case of retailing and wholesaling B&O tax, a claim that someone is acting merely as an agent in making purchases or sales of tangible personal property for another.² It is the specific definition of agency in Rule 159 that we must use in analyzing whether to recognize the taxpayer as an agent in this case.

Rule 159 states, in relevant part:

Any person who claims to be acting merely as agent or broker in promoting sales for a principal or in making purchases for a buyer, will have such claim recognized only when the contract or agreement clearly establishes the relationship of principal and agent and when the following conditions are complied with:

(1) The books and records of the broker or agent show the transactions were made in the name and for the account of the principal, and show the name of the actual owner of the property for whom the sale was made, or the actual buyer for whom the purchase was made.

(2) The books and records show the amount of gross sales, the amount of commissions and any other incidental income derived by the broker or agent from such sales.

Clearly, the taxpayer has not met or complied with the accounting records requirements of Rule 159. Accordingly, for B&O tax purposes, we cannot allow his claim that he was acting merely as the agent of Mr. [A] in making the purchases of OTP.

Another possible exception to B&O liability we have considered is the “casual or isolated sale” exception. WAC 458-20-106 explains that exception as follows, in relevant part:

A casual or isolated sale is defined by RCW 82.04.040 as a sale made by a person who is not engaged in the business of selling the type of property involved. Any sales which are routine and continuous must be considered to be an integral part of the business operation and are not casual or isolated sales.

Furthermore, persons who hold themselves out to the public as making sales at retail or wholesale are deemed to be engaged in the business of selling, and sales made by them of the type of property which they hold themselves out as selling, are not casual or isolated sales even though such sales are not made frequently.

The merchandise list for [the taxpayer’s business] that the taxpayer provided, assuming it was the list he used at the time in question, tends to indicate that the taxpayer did not generally hold himself out as engaged in the business of selling OTP. However, his transactions involving OTP occurred regularly over a period of many months. We have found these were sales. Under the

² RCW 82.04.480 specifically directs DOR to provide by rule what accounting records a taxpayer must keep to have recognized a claim that the taxpayer is acting merely as a broker or agent in promoting sales.

first paragraph from Rule 106 quoted above, they must be considered an integral part of the business operation, and not casual or isolated sales.

The taxpayer has failed to establish any exception or exemption from B&O taxation of the OTP receipts. Therefore, we sustain the assessment of B&O tax, and deny the taxpayer's petition with respect to the B&O assessment.

Tobacco Products tax

The Tobacco Products tax is imposed upon the "sale, use, consumption, handling, or distribution of all tobacco products in this state." RCW 82.26.020(1).^[3] For purposes of the Tobacco Products tax, "tobacco products" means cigars, chewing tobaccos, and all other forms of tobacco, but not including cigarettes. The tax is an excise tax levied on the wholesale sales price of the products. RCW 82.26.020; WAC 458-20-185(3) (Rule 185(3)).

[2] The tax is imposed only once, upon the "distributor" of the OTP. RCW 82.26.020(2); RCW 82.26.030; Rule 185(4)(a). The Tobacco Products tax is in addition to all other taxes owed. For example, distributors, subjobbers, and retailers are liable for business and occupation (B&O) tax on their retailing or wholesaling activities, use tax on tobacco products distributed as samples, and litter tax on the value of the tobacco products. Rule 185(1).

The Tobacco Products tax is imposed at the time the distributor does one of the following:

(a) brings, or causes to be brought, into this state from without the state tobacco products for sale, (b) makes, manufactures, or fabricates tobacco products in this state for sale in this state, (c) ships or transports tobacco products to retailers in this state, to be sold by those retailers, or (d) handles for sale any tobacco products that are within this state but upon which the tax has not been imposed.

RCW 82.26.020(2).

"Distributor" is defined as follows, at RCW 82.26.010(3):

"Distributor" means (a) any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from without the state any tobacco products for sale, (b) any person who makes, manufactures, or fabricates tobacco products in this state for sale in this state, (c) any person engaged in the business of selling tobacco products without this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers, or (d) any person engaged in the

^[3]RCW 82.26.030 expresses the legislative intent behind the tax:

It is the intent and purpose of this chapter to levy a tax on all tobacco products sold, used, consumed, handled, or distributed within this state and to collect the tax from the distributor as defined in RCW 82.26.010. It is the further intent and purpose of this chapter to impose the tax once, and only once, on all tobacco products for sale in this state, but nothing in this chapter shall be construed to exempt any person taxable under any other law or under any other tax imposed under Title 82 RCW.]

business of selling tobacco products in this state who handles for sale any tobacco products that are within this state but upon which tax has not been imposed.

The term “person” is defined in RCW 82.26.010(12) and Rule 185(2)(1). It means any individual and virtually any entity, but excludes any person immune from state taxation, including any federally recognized Indian tribes and enrolled tribal members, conducting business within Indian country, as defined in WAC 458-20-192.

The term “business” is defined in RCW 82.26.010(8) and Rule 185(2)(h) as “any trade, occupation, activity, or enterprise engaged in for the purpose of selling or distributing tobacco products in this state.”

The Indian smoke shop from which the taxpayer purchased the OTP was not a “person,” and therefore cannot be treated as the “distributor” of the OTP for purposes of the tax. The taxpayer is a “person” who handled the OTP in this state, and potentially a “distributor.”

The taxpayer contends he does not fit the RCW 82.26.010(3) definition of “distributor,” because he was not engaged in the business of selling tobacco products in this state. Based on the objective evidence before us, we find the monies the taxpayer received for the OTP were gross income of his wholesaling business. He was a wholesaler. He purchased the OTP in the name of his business. He paid for the OTP with a credit card issued to the business. He received a mark up or fee for the wholesale sale. There is no objective evidence that he purchased the OTP as the agent of another person.

[3] The specific definition of agency set out in Rule 159 addresses only B&O tax and retail sales tax, but Chapter 82.26 RCW also contains detailed recordkeeping requirements for distributors and sellers, to enable DOR to administer the tax. It would be incompatible with the recordkeeping requirements of Chapter 82.26 RCW to allow a claim that a person was acting merely as an agent in purchasing and receiving payment for tobacco products by a person who has not maintained any records documenting the name and address of the principal, that the transactions were made in the name and for the account of the principal, and the dates and quantities of purchases for the principal. We cannot, consistent with the recordkeeping requirements of Chapter 82.26 RCW, recognize the taxpayer’s claim of agency.

[4] Even under the general definition of agency that applies to an analysis under Rule 111, we could not allow the taxpayer’s claim of agency. An agency relationship generally arises when two parties consent that one shall act under the control of the other. *Rho Co. v. Department of Rev.*, 113 Wn.2d 561, 570, 782 P.2d 986 (1989). As is the case with other exceptions and exemptions, the burden is on the taxpayer to establish the existence of an agency relationship. *Id.*; *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 178, 60 P.3d 79 (2002). The taxpayer has provided no evidence that he was acting under the control of someone else when he purchased the OTP, other than self-serving statements made after the fact. There is no contract, statement signed by the purported principal, other documentary evidence, or oral testimony by the purported principal to support the taxpayer’s bare assertions. The significance of the three sales order forms that have Mr. [A’s] name on them is not apparent on the face of the documents.

They could indicate that Mr. [A] was purchasing the OTP from the taxpayer, or that Mr. [A] was reimbursing the taxpayer, or something else. Even though the taxpayer appeared to be credible, unsubstantiated, self-serving assertions made after the fact are neither reliable nor persuasive. They are insufficient to satisfy the burden of establishing an exemption or exception to tax. *See* Det. No. 90-4, 9 WTD 045 (1990); Det. No. 04-0098, 23 WTD 331 (2004).

We find the taxpayer engaged in the activity of purchasing and receiving payment for the tobacco products for the purpose of selling tobacco products in this state, *i.e.*, the activity was a “business” as defined in RCW 82.26.010(8) and Rule 185(2)(h). Since the activity was a business, the taxpayer fits the definition of “distributor” in RCW 82.26.010(3)(d). He was engaged in the business of selling tobacco products in this state. He was the first person who handled for sale the OTP in this state. The Tobacco Products tax had not been imposed on the OTP at the time he first handled it in this state.

We find that the taxpayer was the distributor of the OTP for purposes of Chapter 82.26 RCW. As the distributor, he was liable for the Tobacco Products tax on the wholesale sales price of the OTP. RCW 82.26.030; RCW 82.26.020. We sustain the assessment of Tobacco Products tax, and deny the taxpayer’s petition with respect to the Tobacco Products portion of the assessment.

Litter tax

RCW 82.19.010 levies a litter tax upon manufacturers, wholesalers, and retailers of certain products that are sold in Washington or shipped into Washington. The measure of the tax is the gross proceeds of sales of the products listed in RCW 82.19.020. Among the products listed in that statute are tobacco products. RCW 82.19.020(3). WAC 458-20-243(3) defines “tobacco products” as including all of the products subject to the excise tax of Chapter 82.26 RCW.⁴

Taxpayer appeals the assessment of litter tax, asserting he was not a wholesaler of the OTP. We analyzed that assertion above, with respect to B&O liability, and decided the issue against the taxpayer. As a wholesaler of the OTP, the taxpayer is liable for litter tax on the OTP, on the gross proceeds of his wholesale sales. We deny the taxpayer’s appeal of the litter tax portion of the assessment.

Finally, we note that if the taxpayer was in reality acting solely as an agent, he could have protected himself by satisfying his responsibilities under the Revenue Act to “[k]eep accurate and complete business records,” and to “keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable.” RCW 82.32A.030(3); RCW 82.32.070(1). When a business person fails to keep complete and accurate records, DOR may base an assessment upon the records the person provides, and “[a]ny person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceeding, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.” RCW 82.32.070(1).

⁴ WAC 458-20-243 defines the terms in the prior codification of the same list as RCW 82.19.020.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 23rd day of February 2005.